GOODWILL AND OTHER NONDEPRECIABLE AND DEPRECIABLE INTANGIBLE PROPERTY AS "INVESTED CAPITAL"*

THE subject of intangible property under the federal tax laws is somewhat misunderstood. Many errors of an important nature have undoubtedly been made in reference thereto. The purpose of this paper is to point out the situations as they often exist and to give practical suggestions as to how to handle them insofar as authorized by the law and the treasury decisions and regulations.

Intangible property as giving rise to a question of invested capital is classified as follows:

I. The intangible property on which *no depreciation* or depletion can be taken in computing the income subject to taxation. The usual intangible *non*-depreciable property is:

A. Goodwill purchased as such by cash or stock.

B. Secret processes or formulae purchased by cash or stock or created by expenditures for their development.

C. Trade marks or trade brands purchased by cash or stock or created by expenditures for their development.

D. Business development expenses; usually set up from advertising, etc.

E. Franchise expenses; organization expenses, etc.

II. The intangible property on which *depreciation* or depletion can be taken in computing income subject to taxation. Such intangible depreciable property is:

A. Patents.

B. Copyrights.

The distinction between the two classifications—non-depreciable and depreciable—is of extreme importance. Many corporations are ignoring the beneficial possibilities that lie in, and the necessity for, the correct handling of these assets; both from the point of view of invested capital and from the point of view of deductions that can and should be made from taxable income.

* This article is a continuation of one in the MICHIGAN LAW REVIEW for January, entitled DOMESTIC CORPORATE TANGIBLE AND INTANGIBLE INVESTED CAPITAL.

GOODWILL AND OTHER NONDEPRECIABLE INTANGIBLE ASSET.

The average balance sheet frequently shows a listing of a non-depreciable intangible asset. The initial step to take is to analyze the items so set out.

The first question to determine is:

Is the goodwill or other non-deprecible intangible asset camouflaged "discount on stock?"

By this is meant a situation as follows:

> A business sells it's stock below par—say for $90 per share. The issue is $100,000, the discount of $10,000 being charged to goodwill.
>
> The $10,000 obviously is not invested capital; it represents no money expended and is deductible from Capital and Surplus.

The discount on stock is present in a more subtle and indirect manner, where a common or other stock bonus is given with the purchase of bonds or stock. To illustrate:

> A business sells it's preferred stock and bonds and for every bond and share of stock one share of common stock is given as a bonus.
>
> The bond issue is $100,000.
>
> The preferred issue is $100,000.
>
> The common stock is $100,000 and is charged to "Goodwill" or "Franchise," etc.
>
> The $100,000 or any part thereof is not invested capital.

The analogous discount on stock is present in a further situation, i. e. the difference between the selling and holding value of treasury stock. To illustrate:

> $100,000 treasury stock is donated to A Co. and held in "Donated Surplus" as $100,000. The stock is disposed of at $60.00 per share and the difference instead of being charged to "Donated Surplus" is charged to "Goodwill" or some other account.
>
> The $40,000 is deductible in full from invested capital.[1]

It sometimes happens that the discount on stock has been completely or partially charged off. If this is the case, there is no necessity for reconstructing the part charged off.

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[1] Treasury stock as invested capital will be separately considered.

The second question to determined is:

Is the non-depreciable intangible asset of goodwill set out in the balance sheet, purchased from another business (individual or corporate) and paid for in cash?[2] If so, the goodwill item is the clearest cut type of goodwill set out in the law. To illustrate:

> The Jones Co. sells out it's business to the Smith Co. The assets are paid for at book value and $20,000 in cash or promissory notes are given for the goodwill.

Such an item is carried in full on the books of the Smith Co. as invested capital. If such an item has been written off *in* whole or *in part,* it can be resurrected and put in invested capital.

If in any year in computing the income subject to taxation any depreciation has been taken in writing off the foregoing type of goodwill an amended return should be filed.

In order to uncover such "goodwill" that may have been written off, it will be advisable to compare the annual balance sheets running back for a number of periods. In some instances this comparison might go back fifteen years.

The reconstructed credit could be called "Surplus Appropriated for Goodwill" which is in effect what is recommended by the Federal Reserve Board in it's set up of the balance sheet.[3]

The third question to answer is:

Is the non-depreciable intangible asset of "goodwill" set out in the balance sheet, purchased from another business and paid for in stock? This type of goodwill is the most common form of goodwill. It can arise in two ways:

I. By a direct specific purchase of goodwill by stock. To illustrate:[4]

> The Jones Co. sells out to the Smith Co. and receives cash or notes or bonds for it's assets. The estimated value of the goodwill is paid for in $15,000 par value stock and set up as goodwill $15,000.
>
> Smith & Co. are capitalized for $100,000.

II. By a reorganization of some kind or a sale of a business. To illustrate:[5]

> An individual or partnership form of business is converted to or absorbed in a corporate form of organization; or

[2] Article 60 of the Excess Profits Regulations. If tangible property is used in paying for such goodwill, the value of the tangible property governs.

[3] No. 6—Volume 43—Page 433.

[4] Article 57—Excess Profits Regulations.

[5] Article 59—Excess Profits Regulations.

two or more corporations consolidate; or a corporation already in existence, reorganizes.

In cases like the foregoing there is no special allocation of stock for each asset taken over. The assets are set up on a basis of book value or some other value basis and "Goodwill" is set up to absorb the difference if any. It is sometimes extremely difficult to determine the true starting point for goodwill in such a case.

The beginning point is the date of the transfer of the business, prior to March 3, 1917 or subsequent to March 3, 1917. If the reorganization took place prior to March 3, 1917, the procedure to adopt is to set up the tangible assets at the appraisal value when the transfer took place, and set up the difference, if any, as goodwill. To illustrate:

Smith & Co. a partnership have the following assets when it reorganizes on a corporate basis on Jan. 1, 1910:

Land	$ 15,000
Buildings	20,000
Equipment	20,000
Inventory	15,000
Cash, etc.	5,000
	$ 75,000

The stock issued therefor was $100,000 and $25,000 was carried in "goodwill." The assets on Jan. 1, 1910 showed an appraisal of:

Land	$ 20,000	and is deemed to have been paid in stock......	$ 20,000
Buildings	25,000	and is deemed to have been paid in stock......	25,000
Equipment ...	20,000	and is deemed to have been paid in stock......	20,000
Inventory ...	15,000	and is deemed to have been paid in stock......	15,000
Cash	5,000	and is deemed to have been paid in stock......	5,000
	$ 85,000		$ 85,000

The starting point for goodwill therefore is $15,000 and not $25,000. It is not the ending point in it's valuation by any means.

There is a decided misunderstanding on the amount of goodwill that can be taken as invested capital. It is generally assumed to be:

> 20% of $100,000, the amount of the par value stock outstanding March 3, 1917, or the amount of the par value of the stock given for the goodwill, $15,000, whichever is the smaller. In our illustrative cases this smaller amount is $15,000.

However, the law and the treasury department regulations[6] expressly provide that if the value is the *lowest* of the three measurements; 20% of outstanding capital stock March 3, 1917, par value of stock issued for the goodwill; or value of goodwill; the value is to be used.

> Thus, if the goodwill of the Smith Co. were worth only $10,000, $10,000 would be the amount used. If it were worth $17,500, $15,000 would be the amount used.

The valuation of the goodwill purchased by stock for purposes of the computation of invested capital is to be determined by the valuation of the goodwill *as of the time it was acquired.*

Unfortunately under the excess profits tax act the treasury department or congress has not formulated any rules of good will valuation, as was done in the case of the capital stock tax.[7] In fixing on the value of goodwill, therefore, the taxpayer is left a somewhat liberal field in which to wander.

In the situation of the goodwill purchased outright for stock, set out in the illustration of the Jones Co. selling out to the Smith Co. there is no logical objection to using any of the following methods whichever is the most favorable for the valuing of the goodwill.

> The subscription price of other stock sold a short time before or after the sale of the goodwill.
>
> The market price of the stock as reflected in general or restricted sales a short time before or after the sale of the goodwill.
>
> The earning power of the prior business.

In the situation of the goodwill arising out of reorganization the same general principles of valuation, if present in anyway, may also be used.

In considering the earning power the practical question is to handle the matter so as to give the client the most favorable outlook

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[6] Article 57—Excess Profits Regulations.

[7] Exhibit "C"—Form No. 707 and Treasury Decision 2503.

and at the same time present the case so no government inspector can take exception to the procedure adopted by citing any regulation, decision or passage from the law.

The 1917 return of excess profits will be in all probability substantially the same on this point as the 1917 return; the questions relative to goodwill are set out on page No. 2, schedule C—C1 of the 1917 form.

If the earning power of the old business, averaged on a one, two, three, four, or five years basis, preceding the year of organization whichever average is the most favorable, and capitalized on some such basis, as the basis outlined by the Treasury Department in Treasury Decision 2503, viz:

Banking west of the Mississippi River 8%.
Banking east of the Mississippi River 6%.
Mercantile 10%.
Mining 10%.
Industrial 10%.
Oil Producing Companies 15%.
Oil Refining Companies 10%.
Public Utilities 8%.
(1) Railroads
(2) Light and Power
(3) Electric Railways

shows the goodwill worth the par value of the stock issued for it, answer the first question *NO*, and the rest of the interrogatories as will fit the client's case.

The goodwill value on the foregoing basis of the earning power of a business is computed thus:

> The average yearly earnings of a certain public utility corporation on a two year's basis preceding the reorganization or purchase are $20,000. $20,000 times 12½ equals $250,000, the capitalization at 8%. Goodwill, called franchise in this case, is carried at $50,000. The net assets were worth $122,500 when the reorganization took place. Therefore, $250,000 minus $122,500 equals $127,500, the value of the goodwill.

If the earning power of the business *preceding* the reorganization will not show a valuation of goodwill equivalent to the par value of the stock given for the goodwill, and there is no question of computing the item in the prewar period, ascertain whether or not a

period subsequent thereto, preferably an average of the earning for 1915 and 1916, will do so.

While there is no express permission to do this, as it incorporates an element of futurity in the valuation of goodwill, that strictly speaking does not belong there, yet if properly handled there is no reason for not using the element of futurity.

When the earning power of succeeding years is used attach a rider to the return reading as follows:

> "The goodwill item was based on the future earning power of the ———— Co. resulting from the ———— (reorganization, etc. as the case may be.)
>
> The earnings of the ———— Co. during a period fairly measurable of this earning power shows a goodwill to be worth the par value of the stock given therefor $———, (or if less than par but greater than the value of the goodwill on earning prior to reorganization, etc. insert the value.)

The goodwill purchased by *stock* and set up after March 3rd, 1917, or the goodwill resulting from a reorganization or consolidation after March 3, 1917, is subject to a different rule.

Under the 1917 law and regulations,[8] effective for 1917, if one or more of the 50% of the controlling interest in the old organization continues to exercise 50% or more of the controlling interest in the new organization, the goodwill is not considered. To illustrate:

> Jones & Co. on April 1, 1917, incorporate for $200,000 taking over the appraisal assets of the partnership at $180,000 and setting up the goodwill at $20,000.
>
> The goodwill is not admissible.

If the new company is not 50% controlled by one or more of the old control, under the 1917 law and regulations and effective for the year 1917, the goodwill is measured in the same manner as if the reorganization had taken place, prior to March 3, 1917.

Under the proposed law[9] for 1918, the change of ownership after March 3, 1917, irrespective of 50% control or less than 50% control being carried over, the goodwill item paid for or reflected in *stock* will be excluded from invested capital. To illustrate:

> Jones & Smith partners of Jones & Co. sell their business to Jones & Co. Inc. composed of A and B. The assets are

[8] Article 50—Excess Profits Regulations.

[9] Section 326—Paragraph No. 5.

> valued at $120,000 for which *cash* is paid. $30,000 in *stock* was paid for goodwill.
>
> This latter item cannot be included as invested capital of Jones & Co. Inc.

The suggestions already noted in regard to the reconstruction of goodwill paid for in cash and written off in whole or in part, should also be noted in regard to goodwill purchased or reflected in stock.

Where the stock used in paying for goodwill has *no par value,* or where in reorganization the goodwill is reflected in no par value stock, the situation is handled somewhat the same. The value of the goodwill must not exceed 20% of the value paid in on the total issued stock outstanding March 3, 1917.

There is a species of goodwill, trademark, trade name, etc. that does not represent a purchase by cash or stock, but rather expenses incurred in connection with the development of the foregoing items and which have been capitalized.

The point to observe in considering expenditures of the foregoing nature is that their character, from the point of view of federal tax laws is dual; when made they are charges to income if so desired, or charges which may be capitalized, if so desired. It sometimes happens that in advertising appropriations of a certain character, a certain proportion thereof is charged to "Goodwill," "Trademark," etc. and charged off from time to time in the future. To illustrate:[10]

> The Jones Co. in 1913 expended $50,000 for the general advertising of trade brands, and charged $35,000 to profits and $15,000 to goodwill.
>
> The profits for 1913 after charging in the $35,000 amounted to $20,000 on which sum the income tax was paid.
>
> The $15,000 was charged off in 1914, 15 and 16 but no deduction was, nor could be taken in computing the income subject to the federal income tax. For 1917 and 1918, the $15,000 can be considered as invested capital.
>
> In this case charge "goodwill" and credit "surplus appropriated to goodwill."
>
> If in 1914-15-16 $5,000 had actually been taken as an annual deduction an amended return can be made for those years and the $15,000 reconstructed. If in 1913 the $15,000 had been charged to the profits and a return of $5,000 had been made, no goodwill can be reconstructed as invested capital.

[10] Article 64—Excess Profits Regulations.

Where such expenditure has been made in years prior to 1913 and although actually set up at that time as a goodwill item and then charged off in succeeding years, such item under the language of the regulations cannot impliedly be set up again in 1917 and 1918 as invested capital.

Unfortunately during 1913 and succeeding years, every item possible was dumped as a charge into profit and loss, to lessen the tax that should be paid. If the high rates in 1917 and 1918 could have been foreseen and that the basis of computation would have been "invested capital" many of these charges would have been legitimately capitalized during the years of a low tax rate and when there was no invested capital element in the computation.

At the present time therefore the scrutiny is confined to the years in which a heavy loss has occurred and in which there are items charged to profit and loss that may be capitalized. To illustrate:

> Jones Co. in 1915 organized for business. They advertised extensively and in 1915 the advertising of $35,000 was charged to profit and loss. The earnings were $10,000 and after being charged with $35,000 there was a net loss of $25,000. No income tax was paid.
>
> $25,000 can be reconstructed as invested capital.

In the years preceding 1913 that showed a loss, care must be exercised in applying this principle. If not too far back, the principle is soundly applicable.

The fourth question to determine is:

Are the organization and franchise expenses properly handled and are such expenses called by the most appropriate name?

Under the law of 1917 and under the proposed law for 1918, organization and franchise expenses under certain conditions are legitimate additions to invested capital. Franchise and other expenses of a promotional nature are:

> The organization expenses such as legal fees paid in incorporating, state fees for stock, promoters fees in selling stock, etc.

The point to determine in this case, like the situation of advertising noted, is, that the charges if made to current expense and taken as a charge against income subject to federal taxation in 1913-14-15-16 or 17, except as hereinafter set out, cannot be resurrected for the purpose of invested capital.

The further point to observe however is, that if any year of incorporation since 1913 shows a loss, the loss, in so far as it is reflected in charges of the foregoing nature can be reconstructed. To illustrate:

> The Jones Co. incorporated in 1913. The fees paid the promoters for selling the stock, the legal fees and the state fees amounted to $25,000.
>
> The profits for 1913 amounted to $20,000. The charges of $25,000 were made against this amount and no tax was paid. The only amount that can be reconstructed for invested capital is $5,000.

A further point to observe, is that under article 64, paragraph 2, any organization and other expense of the foregoing nature which had actually been charged to expense prior to 1913 and has therefore never been capitalized can be reconstructed in full as invested capital, although there was no loss in the year in which the charges were made.

It logically follows that such organization and franchise expenses which have been actually set up as capital charges and which have since been written off, can be set up at this time and is from the time of its original occurence an intangible asset.

In some instances the organization or other expenses are paid for in whole or in part, by the stock of the corporation. As an illustration:

> A broker, promoter or other agency will float a stock issue and in lieu of commissions will take stock for his services, say $50,000, the item is set up as organization expense or goodwill or with some similar designation.

Such an item is not necessarily held at par in computing invested capital but only at the fair value of the services which are not to exceed the par value of the stock.

The question of the value of the services may be difficult to determine as there is no set rule on this point. The subscription price of the shares is indicative to some extent and so is the market value of the stock at the time the services were rendered. The difference between the value of the services when rendered and the par value of the stock is of course the same as "discount on stock" and handled in the manner already outlined. If such expenses paid for in stock have actually been taken as a deduction from income in computing income subject to the income tax, handle in the same manner as already outlined.

The proposed law[11] for 1918 expressly provides that promotional organization or charges of this nature, *paid by stock* is not included in invested capital, if thus paid for *on or after March* 3, 1917.

The item of organization expense, promotional expense, and other capital charges of this nature, should be shown as "Franchise and other intangible assets."

Under Treasury Decision 2499 handed down in June, 1917, the internal revenue department has taken a somewhat peculiar stand on the subject of organization expenses. Thus for 1917 it is clearly established that organization expense is not a deduction from taxable income, but should be capitalized as "Franchise, etc."

If the 1917 return actually contained a deduction for organization expense, a correction should be made and the attorney and accountants' fees, fees paid to the state authorities prior to, or coincident with the securing of the charter and incorporation and other organization expenses, should be set up as a capital account for 1918 and designated as "Franchise and other intangible assets."

The treasury decision seems to be retroactive in its effect and the organization expenses taken as a deduction in 1913-1914-1915 and 1916 seemingly may be reconstructed if proper steps are taken. If the organization expenses are of enough moment to warrent their inclusion in invested capital for 1917 and 1918, we suggest that the following letter be sent to the district collector with an amended return covering these years.

> "Treasury Decision 2499 has been called to our attention. Through an error and a misunderstanding of the requirements of your office in submitting our return for 19—, we deducted certain items which are covered by the foregoing decision as not being deductible.
>
> We enclose herewith an amended return covering the deduction taken in error and also enclose our check covering the amount due to the department of internal revenue because of such error.
>
> If your office does not wish us to correct this item please return the check to us."

When the check has been put through the bank, set up the item as "Franchises, etc." and credit "Surplus appropriated for franchises, etc."

[11] Section 326—Paragraph 5.

A few suggestive remarks are:

I. Separate Goodwill, trademarks, and other non-depreciable intangible property from "patents" or "Copyrights." Very often the grouping of a balance sheet is as follows:

"Patents, trademarks, goodwill, etc."

The reason for distinguishing between the two kinds of assets is that patents are depreciable on a straight line basis—the other assets are not depreciable. What is left after valuing the patent item is other intangible property of a nondepreciable nature.[12]

II.

PATENTS AND COPYRIGHTS—DEPRECIABLE INTANGIBLE PROPERTY.

Under the federal tax laws, patents are considered as property subject to depreciation from year to year on a straight line method. The annual depreciation charge based on the cost to acquire the patent is a deduction in the computation of the income subject to taxation. Patents are usually acquired in the following manner:

I. By purchase, payment therefore being made—

> (*a*) by cash or primary obligations of a company.
> (*b*) by stock.

II. By internal development.

In the case of patents purchased outright by cash there is no difficulty presented. The asset is set up *at cost* and depreciated over the period it has to run. To illustrate:

> The Jones Co. in 1915 purchase a patent for $10,000 with 10 years to run. Depreciation is run through at $1,000 per annum. If the patent had 17 years to run when acquired (the full period of a patent) the depreciation rate would be 1-17 of $10,000 per annum.)

It often times happens that a patent will become obsolete before the expiration date thereof; for instance:

> Patent acquired in January 1915 for $10,000 cash, expiring in 1925. In 1917 the patent becomes obsolete; only $2,000 having been charged off. The question comes up—can the $8,000 be charged off in 1917? This question is answered in the negative. The $8,000 cannot be charged off but only 4-5 of $8,000 or $6,400. The 4-5 is arrived at by taking the number of years the patent has to run, when it became obso-

[12] The method of patent regulation will be taken later.

> lete and compare it with the number of years the patent had to run when acquired. The ratio (4-5 in this case) of the amount not depreciated is the limit of deduction for 1917. Under the regulations, apparently no more depreciation can be taken as a deduction on the patent and the patent is wiped out of the assets as "invested capital."

The somewhat difficult case of determining cost value of patents is where the patents are paid for in stock. As a matter of practical procedure ascertain the value as follows, whichever is the most favorable:

> If the stock given had any market value although limited when the patent was acquired, such market value logically can be used to measure the value of the patent to be set up on the books.
>
> The subscription price of the stock at the time the patent was acquired, or a reasonably short time before or after the patent was acquired, logically is also measurement of value of the shares given for the patent. For instance:
>
> The subscription to the common stock was at $75.00 per share. The patent wa spaid for by 100 shares. It is fairly worth $7,500 and should be carried on the books at that price and depreciated on that basis.
>
> If no market value existed when the patent was acquired, as shown by private or public sales of stock, or no subscription price of the stock was available, it may be that other evidence of value is obtainable. For instance:
>
> Jones sells some tangible property to the Smith Co. valued at $200,000 for which it issued $400,000 worth of stock, par value of $100. A patent is purchased for 200 shares of stock. The patent under this measurement is worth $10,000. Such a measure must be used very cautiously.

It sometimes happens under the foregoing measurements, the worth of the patents is above the par value of the stock issued therefor. For the purpose of invested capital the limit of inclusion is the *par value* of such stock.[13]

In the computation of depreciation of the patent the rate is based on the value of the *patent when acquired,* and not necessarily limited by the par value of the stock.

> The par value of shares of stock given for a patent may be $10,000. The stock is worth $30,000 when given. The

[13] Section 326—Paragraph 4.

depreciation rate is based on $30,000 until the $30,000 is written off, subject to the obsolence rule noted.

If in 1917 or 1918 the sum of $10,000 had been written off, no amount of the patent is eligible for inclusion in invested capital.

The difficult question of patent valuation arises when the patent goodwill and miscellaneous intangible and tangible assets, land, buildings, machinery, etc. are thrown into one group and paid for in stock; *no stock being apportioned to each particular kind of asset taken over.* As we have noted, such a situation arises in a change from individual partnership organizations to the corporate form or from a reorganization of a corporation or from a consolidation of several corporations. The book value of the assets of the old organization is often used or some arbitrary value is used in setting up the assets. In such a case the rule formulated by the department in Article 59, Regulations 41 and construed in Letter No. 5, March 5, 1918, is:

> Value the *tangible* property, cash, accounts receivable, land, buildings, equipment, machinery and other tangible fixed assets not at book value or other value but the value of the *date* the reorganization etc. took place. Then value the patent. The remainder constitutes the goodwill and other intangible assets.

As an illustration, the following assets were taken over under a reorganization:

Cash ....$	5,000	deemed to be paid in stock, par value........$	5,000
Land	250,000	deemed to be paid in stock, par value........	250,000
Buildings	35,000	deemed to be paid in stock, par value........	35,000
Equipment	45,000	deemed to be paid in stock, par value........	45,000
Patent	25,000	deemed to be paid in stock, par value........	25,000
	$ 360,000	deemed to be paid in	
Goodwill	40,000	stock, par value........	40,000
	$ 400,000	Capital stock issued..	$ 400,000

The patent valuation in this case often is extremely difficult to arrive at. Every case must be considered on it's own facts. It would be useless to endeavor to make any rule of thumb.

The subscription price of any new stock issued a short period prior or subsequent to the acquisition of the patent, the general or restricted market value of the stock a short period prior or subsequent to the acquisition of the patent, is also indicative of the value.

The valuation of the patent placed on it by experienced unbiased men familiar with the worth of the patent is also indicative of the worth of the asset. In case of patents developed by a business, the patents are carried at cost. Such charges ordinarily are:

I. Experimental material, labor and overhead costs allocated to the patent. It is very seldom that such accurate costs can be obtained.

II. Legal fees and other fees connected with the perfection of the patent.

III. Legal or other fees expended in prosecuting or defending patent infringement suits.

If for instance a patent has five years to run and a patent infringement suit is brought and legal fees are expended to the amount of $5,000, the fees are charged to patents and spread over a period of five years.

Under the law applicable to 1917[14] and also for the proposed law applicable to 1918, when intangible assets were purchased prior to March 3, 1917 for stock, the 20% limitation applies not only to goodwill but also to patents and copyrights. To illustrate:

> In 1914 a corporation purchased goodwill for $25,000 stock, and patents for $15,000 stock. On March 3, 1917 the outstanding capital stock was $175,000. The 20% limitation is $35,000.
>
> The total for goodwill and patents that can be included in invested capital is $35,000. The sum of $5,000 is taken as a deduction.

Where the goodwill and patents were purchased for stock subsequent to March 3, 1917, the proposed law for 1918 differs somewhat from the 1917 law. To illustrate:

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[14] Article 58—Excess Profits Regulations—Section 326—Paragraph 4.

> A company composed of A, B, C, and D organized in 1918 with a capital stock of $100,000. It purchased a business from E and paid for E's goodwill $25,000 in stock and for certain patent rights $5,000 in stock.

Under the 1917 law the goodwill and patents can be included up to $20,000, the deduction from capital and surplus being $10,000.

Under the 1918 law the goodwill is not included. The patent rights are included up to $20,000 of stock. The total deduction from capital and surplus outstanding at the beginning of the year therefore is $25,000.

FREDERICK THULIN.

Chicago.